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IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

GTE Service Corporation, GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Midwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE Hawaiian Telephone Company Incorporated, GTE West Coast Incorporated, Contel of California, Inc., Contel of Minnesota, Inc. and Contel of the South, Inc.,	Case No. ______
	(D.C. Circuit Case No. 96-1319)
	(Consolidated with Case No. 96-3321)
Petitioners,	
v.	
Federal Communications Commission and United States of America,	
Respondents.	

MOTION FOR STAY PENDING JUDICIAL REVIEW AND FOR EXPEDITED JUDICIAL REVIEW

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MOTION FOR STAY PENDING JUDICIAL REVIEW AND FOR EXPEDITED JUDICIAL REVIEW

GTE Service Corporation and its affiliated telephone operating companies (collectively, "GTE") respectfully request a stay of the Federal Communications Commission's First Report and Order,[1] and the rules promulgated thereunder, purporting to implement the local competition provisions of the Telecommunications Act of 1996 (the "Act").[2] In that Act, Congress carefully crafted a fast-track process to set the terms of local competition -- a nine-month process consisting of private negotiations backed up by particularized and localized arbitrations conducted by state public utility commissions. Six months after passage of the Act, the FCC has derailed Congress's plan by issuing a 700-page order that peremptorily dictates, on a nationwide basis, all material terms of entry into the local market. Those national terms not only violate the substantive requirements of the Act; they would also, if allowed to go into effect, destroy the negotiation and particularized arbitration process crafted by Congress. An immediate stay of the FCC's order before it becomes effective is essential to prevent the FCC's unlawful national rules from irretrievably disrupting the process established by Congress, to prevent other immediate and irreparable harm to GTE that will flow from enforcing rules that directly contravene the Act, and to avert a disastrous false start in the implementation of Congress's plan to promote competition in the local telecommunications industry.

INTRODUCTION

As the Federal Communications Commission (the "Commission" or "FCC") has recognized, the Telecommunications Act of 1996 "fundamentally changes telecommunications

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[1] First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 (Aug. 8, 1996) ("First Report and Order").

[2] Pub. L. No. 104-104, 110 Stat. 56 (to be codified at 47 U.S.C. § 151 et seq.).

regulation." First Report and Order ¶ 1. By unleashing competition in the local telephone exchange, the Act mandates a sweeping transformation of the telecommunications industry. At the same time, the Act holds out the promise of what Congress characterized as a "pro-competitive, de-regulatory" framework for accomplishing that transformation. Joint Explanatory Statement of the Committee of the Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. 113 (1996).

The Act promotes its pro-competitive goals, in part, by imposing on incumbent local exchange carriers (incumbent "LECs"), such as petitioner GTE, several duties, including the duties (i) to allow other telecommunications carriers to interconnect with the incumbent LEC's network ("interconnection"); (ii) to provide carriers access to elements of the incumbent LEC's network on an unbundled basis ("access to network elements"); and (iii) to sell to other carriers at wholesale rates any telecommunications service that the incumbent LEC provides to retail customers ("services"). See generally § 251(c).[3]

To implement these "local competition provisions," Congress explicitly relied on a system of private negotiations between incumbent LECs and other carriers, backed up by binding arbitrations conducted by state public utility commissions. Thus, under the Act, incumbent LECs must "negotiate in good faith" to reach agreements allowing competitors to use their networks, see § 251(c)(1), and agreements reached by such negotiation are explicitly freed from many of the constraints of the Act, see § 252(a). If the parties cannot reach an agreement, the Act enlists state utility commissions to resolve outstanding issues in a binding arbitration. See § 252(b). The Act explicitly directs that, in such arbitrations, state commissions shall establish

[3] Citations to the Act are to sections as they will be codified in title 47 of the United States Code. Sections 251 and 252 are reproduced in the attached appendix at Tab A.

any rates on which the parties cannot agree. See § 252(c)(2). The system enacted by Congress thus ensures that where agreements are not left entirely to private parties, arbitrations will involve localized, case-specific decisionmaking. And, by giving the critical role in this process to state commissions, Congress preserved the States' role in regulating the local telephone exchange.

Before the First Report and Order, the system set up by Congress was proceeding apace. Incumbent LECs and other carriers began negotiations promptly after the Act was passed. Some reached agreements without arbitration, and others entered arbitrations in front of state commissions as Congress planned. In short, competition was being implemented in accordance with the Act's market-driven and state-supervised approach.

Then, however, the FCC forced its way into the process. In what can only be described as one of the most audacious power-grabs ever attempted by an administrative agency, the FCC abruptly derailed the process for implementing competition established by Congress. In its place, the FCC erected a 700-page monument to the prowess of the federal regulatory state -- a national code dictating virtually all of the terms and conditions state commissions must impose in arbitrations. In particular, the FCC imposed an inflexible national pricing regime. Under that regime, the FCC has dictated the costs States may and may not consider in setting prices and has prohibited States from even considering the actual, historical cost of an incumbent's network -- prudent investments made to meet state obligations. The FCC has even attempted to prohibit States from setting prices sufficient to cover the true prospective or "forward-looking" costs an incumbent faces in operating its own network, and has required that States instead calculate costs based on a nonexistent, hypothetically most efficient network. In addition, the FCC set specific "proxy" prices that are well below an incumbent LEC's true costs.

According to the FCC, the state commissions must impose these proxy prices in their arbitrations unless they first complete a review of cost studies conducted according to the FCC's terms, and even then the FCC would require the state commissions to justify any departure from those prices. The Commission's rules also purport to impose myriad other burdensome terms on competition, including restrictions prohibiting incumbent LECs from differentiating themselves from competitors and rules requiring LECs to upgrade and reconfigure their networks to accommodate competitors' requests.

The FCC euphemistically claims that its rules will "expedit[e] and simplif[y]" the negotiation and arbitration process. First Report and Order ¶ 56. That is true only in the sense that negotiations are speedier when all the terms have been set in advance. In reality, the FCC's national rules will effectively halt the process set up by Congress, and substitute for it the FCC's own national code for local competition. Indeed, when rumors of the impending First Report and Order first circulated, potential new entrants effectively broke off meaningful negotiations with incumbent LECs to await the anticipated windfall of the FCC's order.

Thus, it is already clear that the system of negotiations and localized arbitrations established by the Act ceases to work if the FCC can promulgate a presumptive set of terms -- and particularly pricing terms -- that skew negotiations from the start. Negotiating under the shadow of such rules, no party will agree to terms less favorable than those dictated by the FCC. In addition, by setting uniform, presumptive "proxy" prices in its abbreviated rulemaking, the FCC has completely circumvented the localized, case-specific evidentiary procedure for setting prices established by Congress and has usurped the role explicitly assigned by Congress to the States.

The damage done by the FCC's rules does not stop there, however. The rules will also have the perverse effect of discouraging true competition and promoting instead the forced conversion of incumbent LECs into simple wholesalers of local telephone service. Congress sought to promote true, facilities-based competition by encouraging the construction of rival networks to compete with incumbents. Thus, as the Conference Report accompanying the Act states, the Act "was designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services." By setting prices for network elements and services far below costs, however, and by imposing other unlawful terms that encourage carriers to purchase and combine network elements from incumbents, the FCC's rules will thwart the development of facilities-based competition. Indeed, even the FCC recognizes that some of its rules granting competitors expansive access to incumbents' networks will "reduce [incumbents'] incentives to offer innovative services." First Report and Order ¶ 282. Instead, the rules will promote a world of "Potemkin competition," where so-called "competitors" merely repackage incumbents' network elements and services and market them as their own. The result will be, rather than rival local exchange networks, one continually degrading network. Incumbent LECs will have no incentive to invest money to upgrade their networks, and new carriers, given the benefit of bargain-basement prices for access to the existing network, will have no incentive to construct competing facilities. This is not the "procompetitive" system Congress envisioned; it is nothing more than an illusion of competition created by a systematic subsidy for competitors.

An immediate stay pending review by this Court is necessary to preserve the process specified by Congress for implementing local competition and to prevent the FCC's rules from irretrievably skewing the transformation of local telecommunications called for by the Act. As we demonstrate below, GTE readily satisfies the factors considered in granting a stay.

(1) Likelihood of Success on the Merits. While a host of infirmities with the Commission's rules can be raised at the merits stage of this case, in this motion for stay GTE focuses on the most glaring and immediately destructive of the Commission's rules -- the pricing provisions. The FCC's pricing rules are plainly unlawful for a number of reasons:

First, and most basically, the FCC exceeded its jurisdiction by promulgating national rules on pricing, since the Act expressly assigns the States authority over pricing terms in arbitrations.

Second, in attempting to impose national pricing rules and proxy prices, the FCC plainly violated the procedures specified by Congress for determining prices. In the state arbitration proceedings required under the Act, Congress established a localized, evidentiary procedure for determining just and reasonable prices "based on . . . cost." § 252(d)(1). See also § 252(d)(3) (prices for services must be based on retail rates less "costs that will be avoided"). The abbreviated rulemaking used by the FCC to determine categorical pricing rules and even specific proxy prices deprived incumbent LECs of the right, guaranteed by the 1996 Act, to demonstrate their true costs on a localized basis through the presentation of evidence. Not surprisingly, the FCC's attempt to substitute an abbreviated rulemaking for the process envisioned by Congress also resulted in arbitrary decisions and the imposition of prices that do not even accord with the FCC's own announced methodology for determining rates.

Third, even if the FCC had the authority to promulgate pricing standards in some form and had not utterly ignored the procedures called for by the Act, the pricing rule adopted by the FCC to govern interconnection and access to network elements is plainly unlawful. By prohibiting States from even considering an incumbent LEC's actual historical costs and by fixing prices that deny incumbents an opportunity to recover their true forward-looking costs, the First Report and Order both violates the plain language of the Act and interprets the Act in a manner that raises grave constitutional questions under the Takings Clause.

(2) Irreparable Injury. If allowed to take effect, the Commission's rules would cause immediate and irreparable harm to GTE and others in at least two ways . First, the First Report and Order will render meaningless the negotiation and arbitration process established by Congress. The Order's pricing rules, particularly its immediately effective proxy prices, remove any incentive for competing carriers to negotiate with incumbents over price. Second, by requiring States immediately to impose below-cost prices on incumbent LECs, the First Report and Order will cause GTE to suffer irremediable losses of customers, revenue and goodwill before this Court has the opportunity to pass on the validity of the FCC's actions.

(3). Lack of Harm to Others and the Public Interest. No significant harm would result from granting a stay because, under a stay, the transition to competition called for by the Act will continue moving forward without delay. Parties will negotiate agreements under the Act and the arbitration process (which has already begun in earnest) will continue unimpeded. In short, the competition that Congress wanted will continue, and in accordance with the process Congress chose.

The Commission's rules are scheduled to go into force on September 28, 1996. If they are allowed to take effect, they will irretrievably derail the process Congress established under the Act and, by triggering a false start in the transition to competition, will misshape the new local telecommunications industry for the foreseeable future. GTE therefore respectfully requests that this Court stay the First Report and Order in its entirety.[4] In the alternative, GTE requests that the Court, at a minimum, stay the pricing rules announced by the Commission since they are most plainly beyond the Commission's jurisdiction and will cause the most immediate harm.[5] Given the importance of the issues presented in this case to the restructuring of local telecommunications already under way under the Act, the Court should also grant expedited review.[6]

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[4] On August 28, 1996, GTE and the Southern New England Telephone Company ("SNET") filed a joint motion with the Commission seeking a stay of the First Report and Order pending judicial review. GTE and SNET informed the Commission that if it had not acted on the motion within 10 days, they would seek a stay from the Court of Appeals. To date, the Commission has not acted on that motion. On September 6, 1996, GTE filed a petition for review before the Court of Appeals for the District of Columbia Circuit. SNET filed a petition for review and a motion for stay before the same Court on September 10, 1996. Pursuant to a lottery system established by 28 U.S.C. § 2112, those petitions and 10 other petitions for review filed in various circuits have been consolidated before this Court along with the petition for review in Iowa Utilities Board v. FCC, No. 96-3321.

[5] Those provisions consist of the following sections of the Commission's rules: §§ 51.501-51.515, 51.601-51.611, 51.701-51.717.

[6] Expedited review to hasten the resolution of this case is warranted in addition to a stay. Therefore, GTE supports the motion for expedition filed by Bell Atlantic Corp., et al., and the briefing schedule proposed in that motion. See Motion for Expedited Consideration and for a Briefing Schedule, Bell Atlantic Corp. v. FCC, No. 96-1318 (D.C. Cir. Sept. 6, 1996). GTE requests that the briefs of petitioners, and any intervenors in support of them, should be due by October 14, 1996; that the briefs of respondents, and any intervenors in support of them, should be due by November 13, 1996; and that the reply briefs of petitioners should be due by November 27, 1996. This schedule will allow for oral argument in this case as early as possible and will ensure a speedy resolution of the important issues the petitions for review present for implementing the Act.

The time for filing petitions for review of the FCC's order, which will expire on October 28, 1996, poses no impediment to the schedule Bell Atlantic and GTE propose. As the certificate of service attached to Bell Atlantic's motion to expedite indicates, that motion was served on all the parties to the FCC proceeding below. Thus, all parties who could petition for review before this Court are already on notice of the expedited schedule that has been proposed.

ARGUMENT

As shown below, GTE readily satisfies each of the factors justifying a stay of the Commission's order pending judicial review.[7]

I. GTE'S PETITION FOR REVIEW IS LIKELY TO SUCCEED ON THE MERITS.

The challenges outlined in this stay motion only touch the tip of the iceberg in terms of the issues that could be raised at the merits stage. Nevertheless, they are sufficient to establish beyond doubt that GTE is likely to succeed on the merits of its petition for review.

A. The FCC Lacks Authority Under the Act To Promulgate National Pricing Rules Governing Agreements Under Section 252 of the Act.

The FCC's attempt to set uniform national pricing terms is simply a brazen effort to grab power from state commissions by usurping the role Congress assigned to them.

1. The text and structure of the 1996 Act plainly assign authority over pricing to state commissions, not the FCC.

Congress expressly assigned state commissions, not the FCC, the power to determine prices in arbitrations under the Act. In terms that could not be clearer, § 252(c)(2) provides that "a State commission shall . . . establish any rates for interconnection, services, or network elements according to subsection (d)." (Emphasis added). Section 252(d)(1) provides the

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[7] A stay of an agency order pending judicial review should be granted where the applicant can show: (i) likelihood of success on the merits; (ii) irreparable harm absent a stay; (iii) the absence of harm to others if a stay is granted; and (iv) that the public interest favors a stay. See Wisconsin Gas Co. v. FERC, 758 F.2d 669, 673-74 (D.C. Cir. 1985); Reserve Mining Co. v. United States, 498 F.2d 1073, 1076-77 (8th Cir. 1974). Cf. also Antoine v. United States, No. 95-2006 (8th Cir. Sept. 13, 1996) (stay of agency order was granted pending review). It is well settled that where the applicant can demonstrate a higher probability of success on the merits, the standard required for a showing of irreparable harm will be correspondingly reduced. See Cuomo v. Nuclear Regulatory Comm'n, 772 F.2d 972, 974 (D.C. Cir. 1985) (per curiam) ("Probability of success is inversely proportional to the degree of irreparable injury evidenced. A stay may be granted with either a high probability of success and some injury, or vice versa.").

substantive standard that States must apply, directing that "[d]eterminations by a State commission" of rates "shall be based on . . . cost" and "may include a reasonable profit." (Emphasis added). Similarly, § 252(d)(3), governing services, expressly provides that "a State commission shall determine wholesale rates." (Emphasis added). It blinks at reality to read the plain terms of these sections as doing anything other than assigning state commissions, not the FCC, the power to set prices in arbitrations.

If the explicit statutory text were not clear enough, the structure of the Act underscores the same assignment of authority to the States. Section 252(c)(1) provides that the substantive conditions imposed by state commissions in arbitrations must meet the requirements of both "section 251" and "the regulations prescribed by the [FCC] pursuant to section 251." Thus, § 252(c)(1) recognizes that to the extent the FCC has been given explicit authority to issue substantive regulations in § 251, state commissions must ensure compliance with those regulations. By contrast, the very next paragraph -- § 252(c)(2), which addresses pricing -- provides only that a state commission shall establish rates "according to subsection (d)," (emphasis added), with no mention of any FCC regulations. Subsection (d) of § 252 is the provision quoted above that sets the standards state commissions must apply in setting prices, and makes no reference whatsoever to the FCC. The contrast between § 252(c)(1) and § 252(c)(2) could not be plainer. When Congress wanted state commissions to follow the Commission's regulations (as in § 252(c)(1)), it said so explicitly. With respect to setting prices, by contrast, Congress expressly omitted any reference to FCC regulations.

The FCC purports to derive authority over pricing from § 251(d)(1), which simply directs the FCC to "complete all actions necessary to establish regulations to implement the requirements of this section" within six months of enactment. But the Commission's reliance on § 251(d)(1) is utterly misplaced. Section 251(d)(1) has nothing to do with granting the Commission authority to do anything. It merely sets a time limit for tasks the Commission is otherwise given under the Act. The section is a limitation on the Commission's authority -- requiring it to act within a certain time -- not a grant of authority. Moreover, to the extent § 251(d)(1) confirms the FCC's ability to issue regulations, it does so only with respect to tasks expressly assigned to the FCC by the Act. Thus, for example, § 251(e) expressly directs the FCC to "create or designate one or more impartial entities to administer telecommunications numbering." Similarly, § 251(d)(2) acknowledges some role for the FCC in determining which "network elements" must be unbundled. Merely because § 251(d)(1) recognizes a function for the FCC in such discrete matters does not mean the FCC is authorized to issue new rules on matters in which it was not given any role in the statute.

To the contrary, if anything, § 251(d) confirms that the FCC has no authority to determine prices. While it expressly articulates the substantive standards the FCC must apply in considering any rules pertaining to unbundling of network elements, § 251(d) makes no reference to standards governing pricing. Rather, the substantive standards Congress applied to pricing are found only in § 252(d)(1), which dictates the standards state commissions should apply in arbitrations. Thus, by both including substantive standards to govern any FCC rules on unbundling and omitting any standards for pricing, § 251(d) itself strongly confirms that Congress did not intend the FCC to have any role in setting prices.

2. Section 2(b) of the Communications Act confirms that the 1996 Act cannot be construed to give the FCC authority over pricing.

As the explicit text and structure of the Act outlined above make clear, the FCC's claim to authority over pricing rests on a wholly untenable reading of the Act. Indeed, since the Act explicitly assigns authority over pricing to state commissions, there is no silence or ambiguity in the statute that might entitle the FCC to claim deference for its interpretation under the principles of Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984). The principle of Chevron deference offers the FCC no aid in this case for another, independent reason. Section 2(b) of the Communications Act of 1934 provides what the Supreme Court has described as "its own rule of statutory construction" with respect to the jurisdiction of the FCC to regulate intrastate communications services. See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 377 n.5 (1986). Section 2(b), in other words, operates as a counter-Chevron rule of construction when the FCC is determining the scope of its jurisdiction over intrastate communications. That rule puts a final nail in the coffin for the FCC's power grab over prices.

Section 2(b) provides that "nothing in this Chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." 47 U.S.C. § 152(b) (1994). This "congressional denial of power to the FCC" over prices and other matters concerning local telephone service can be overcome only if Congress includes "unambiguous" and "straightforward" language in the Act either modifying § 2(b) or expressly granting the FCC additional authority. See Louisiana Pub. Serv. Comm'n, 476 U.S. at 375, 377.

Obviously, neither exception to § 2(b) is present here. Whatever else might be said of § 251(d)(1), that section does not "unambiguous[ly]" and "straightforward[ly]" give the FCC the authority to set prices for interconnection, network elements and services. Similarly, no provision in the 1996 Act expressly modifies § 2(b) to grant the FCC authority to regulate either prices or other local matters under § 251. To the contrary, such a provision was expressly rejected by Congress, for while it was included in the Senate bill, it was not included in the law as enacted. See S. 652, 104th Cong., 1st Sess. § 101(c) (1995). Indeed, even the FCC concedes that no provision of the 1996 Act "contain[s] an explicit grant of intrastate authority to the [FCC]." First Report and Order ¶ 84.

The FCC's only response to the fatal limitations on its jurisdiction in § 2(b) is the assertion that because the 1996 Act purportedly "moves beyond the distinction between interstate and intrastate matters that was established in the 1934 Act," id. ¶ 24, the Commission's rulemaking powers under § 251 should "take precedence over any contrary implications" in § 2(b), id. ¶ 93. But that "reasoning" is plainly flawed at a number of levels.

As noted above, there is simply no grant of authority to the FCC over prices in § 251 to "take precedence" over the rule of § 2(b). In addition, the FCC has the relationship between § 2(b) and subsequent legislation such as the 1996 Act flatly backwards. The Supreme Court has made clear that § 2(b) deprives the FCC of jurisdiction over intrastate communications services unless a later act expressly modifies § 2(b) or expressly grants the FCC such power. See Louisiana Pub. Serv. Comm'n, supra. The FCC's general sense that the 1996 Act impliedly "moves beyond" the jurisdictional limitations in § 2(b) cannot overrule the explicit "congressional denial of power to the FCC" in § 2(b).

Moreover, the FCC's reading of § 251 to imply some basic change in the jurisdictional framework set forth in § 2(b) rests on a clear logical flaw. The FCC assumes that if § 251 applies to issues involving solely the local exchange, it must also necessarily imply a grant of jurisdiction to the FCC to regulate the same matters. See First Report and Order ¶ 93. But there is no basis for that logical leap. To the contrary, § 2(b) is phrased in the disjunctive -- it directs that nothing in the Act should be construed "to apply" or "to give the FCC jurisdiction with respect to" intrastate communications. While § 251 may apply by its terms to some matters affecting solely intrastate communications, it nowhere expressly grants the FCC jurisdiction over the same subjects. Since the Act clearly enlists the aid of state commissions to implement its mandates, there is no reason to assume that by merely addressing some intrastate matters, the Act must effect a radical rearrangement of the jurisdictional division between the FCC and the States.

B. By Setting Rates Through an Abbreviated Rulemaking, the FCC Short-Circuited the Fact-Specific, Adjudicative Process Required by the Act for Setting Prices and Produced Arbitrary and Capricious Results.

Congress's decision to give authority over pricing exclusively to state commissions is not simply a jurisdictional technicality devoid of substantive import. To the contrary, the role assigned to state agencies is inextricably linked with the procedures Congress devised in § 252 for setting prices based on a LEC's costs. By design, the arbitrations required by the Act were to be evidentiary proceedings involving fact-specific, essentially adjudicative examinations into the circumstances of particular carriers. The arbitrations thus require local supervision by individual state commissions.

By claiming authority over pricing for itself and by using a rulemaking to set both presumptive proxy prices and mandatory pricing rules to govern state decisions, the FCC has completely circumvented the procedures designed by Congress. In addition, by attempting to use the record compiled in an expedited rulemaking to accomplish pricing decisions that Congress expected to be handled through adjudicative proceedings, the FCC has only committed further errors and produced results that cannot meet the standards of reasoned decisionmaking.

In attempting to dictate standardized prices, the FCC erred first and foremost by undermining the procedures Congress established for individualized, adjudicative pricing determinations under the Act. Section 252 makes clear that an arbitration will proceed on the basis of a "petition," to which a party is given an opportunity to respond. Both parties are allowed an opportunity to present "information" to the state commission bearing on the petition, and only issues set forth in the petition and response are to be "resolved" by the state commission. See generally § 252(b). Such an evidentiary proceeding is especially critical to ensure that prices adequately account for the true costs incurred by a particular incumbent carrier. Only such a case-specific, localized procedure could fulfill the statutory command that prices be "based on . . . cost." See § 252(d)(1). See also § 252(d)(3).

The FCC, however, utterly ignored these procedures by attempting to use a rulemaking (and an abbreviated one at that) not only to dictate an inflexible pricing regime, but also to set specific prices. The expedited rulemaking employed by the FCC could hardly be further from the individualized decisionmaking called for in the Act. Parties, after all, were not even given an opportunity to comment on the FCC's final rule or the specific proxy prices the FCC selected before the final numbers were published. In relying on such a proceeding to set prices, the FCC improperly eliminated the case-specific decisionmaking that Congress devised. See Natural Resources Defense Council, Inc. v. Herrington, 768 F.2d 1355, 1396 (D.C. Cir. 1985) ("[A]n agency may not ignore the decisionmaking procedure Congress specifically mandated because the agency thinks it can design a better procedure.").

The destructive impact of the FCC's actions does not end there. The rules the FCC has promulgated will preclude state arbitrations from ever becoming the localized, case-specific adjudications envisioned by Congress. For example, by prohibiting state commissions ab initio from even considering historical costs in determining prices, the FCC has skewed any individualized decisionmaking in the arbitrations. Similarly, by setting presumptive proxy prices, the FCC has foreclosed meaningful case-by-case consideration in arbitrations. It is no answer to these concerns to suggest that the proxy prices are not mandatory and supply only a fall-back solution where States fail to use more specific cost studies. Rather, as the FCC itself has made clear, unless they have approved incumbent LEC cost studies following the FCC's methods, States must apply the proxy prices to meet arbitration deadlines under the Act. See First Report and Order ¶ 619. Moreover, as the submissions of several parties in arbitrations already demonstrate, state commissions are being urged to adopt the FCC's proxy prices immediately to simplify their tasks and to avoid any delays that might accompany the review of cost studies. See Affidavit of Donald W. McLeod ¶ 14 ("McLeod Aff.") (attached to the Joint Motion of GTE Corporation and The Southern New England Telephone Company for Stay Pending Judicial Review ("Joint Motion") before the FCC, attached at Tab E). In fact, at the urging of AT&T, an administrative law judge in California has recently determined that prices in the arbitration between AT&T and GTE will be set according to the FCC's proxies since it would be too inconvenient to work with actual cost studies. Indeed, even though GTE has already prepared and offered cost data in California, this ruling will focus the arbitration instead on simply applying the proxy prices.[8] As this result plainly shows, the FCC's proxies have the perverse effect of forestalling the use of specific cost studies in state arbitrations and precluding the sort of case-specific consideration Congress intended.

Not surprisingly, the FCC's efforts to supplant the adjudicative process devised by Congress with the agency's own ersatz pricing procedures have spawned clear substantive errors. By basing its conclusions on the materials generated in an abbreviated rulemaking, the FCC produced glaringly arbitrary results. For example, the FCC acknowledged that some incumbent

[8] GTE intends to seek review of these decisions immediately before the California Public Utilities Commission.

LECs claimed in comments that they had "made certain historical investments required by [state] regulators that they have been denied a reasonable opportunity to recover in the past." First Report and Order ¶ 707. Nevertheless, the FCC determined that States could not even consider historical costs in setting rates and justified that decision in part on the ground that "[t]he record before us . . . does not support the conclusion that significant residual embedded costs" would be left unrecovered by a forward-looking pricing mechanism. Id. ¶ 707. But the only reason the record contains little evidence on this point is that the FCC circumvented the case-specific evidentiary proceedings in which such evidence could be introduced. In fact, GTE has been compiling precisely such evidence and has already offered it to the California Public Utilities Commission, which is in the midst of determining the magnitude of GTE's unrecovered historical costs. The evidence the FCC claimed was lacking thus not only exists, but is currently being presented in the fora designated by Congress -- the state arbitration proceedings. For the FCC to justify its decisions based on a supposed lack of such evidence after the FCC itself evaded the process by which a record with such case-specific materials could properly have been built is nothing short of Kafkaesque.

Further examples of arbitrary action appear in the FCC's explanations for its proxy prices. Those prices were based on cost studies conducted by several states and on cost models proposed by parties. See First Report and Order ¶¶ 792, 811-14. The FCC erred in its use of both the state cost studies and the cost models.

First, after outlining a detailed method for measuring costs, the FCC proceeded to set prices based on state studies that used different methods, an error best illustrated by the selection of prices for unbundled loops. The FCC determined as a general matter that prices should be set based on the "total element long run incremental cost" ("TELRIC") of providing a particular network element plus a reasonable allocation of joint and common costs.[9] The cost studies used for loop prices, however, and particularly the Florida studies, were not based on the FCC's new "TELRIC-plus an allocation for joint and common costs" method. To the contrary, the Florida studies used a measure of costs known as "total service long run incremental cost" ("TSLRIC") and omitted any significant contribution for joint and common costs. See Affidavit of Dennis B. Trimble ("Trimble Aff.") ¶¶ 5-14 (attached to Joint Motion at Tab E). As the FCC itself has explained, TSLRIC systematically produces lower cost estimates than the FCC's TELRIC method because it fails to capture as many joint and common costs and assign them to a particular service or element. See First Report and Order ¶ 695. In addition, unlike the FCC's stated method, the Florida studies did not require a further allocation of joint and common costs on top of the incremental costs that could be specifically assigned to loops. Despite these obvious discrepancies, the FCC made no effort to explain how the studies from Florida might properly be used in setting rates that would comply with the FCC's declared approach.

The Commission compounded its error by choosing, again without explanation, a proxy rate for Florida that cannot logically be reconciled with the very studies on which the FCC purportedly relied. The Florida commission approved loop prices that produced an overall state weighted average price of $17.28. Given the methods used in the Florida cost studies, the FCC's announced pricing method by definition would logically require an average loop price greater than $17.28. Nevertheless, without any further explanation linking the price it selected

[9] TELRIC identifies the forward-looking costs attributable to an entire element in a LEC's network. Thus, in one sense, it identifies the costs that would be avoided if the LEC eliminated that element from its network. While some joint and common costs of the network that can be specifically allocated between discrete elements are included in TELRIC, the FCC recognized that TELRIC alone would leave substantial joint and common costs unrecovered and thus required that an additional "reasonable allocation" of joint and common costs be considered on top of TELRIC in determining prices. See First Report and Order ¶¶ 694-696.

to the Florida studies (or linking the studies to its own pricing rules), the FCC set the average proxy rate for loops in Florida at $13.68 -- more than 20% below the average rate set by Florida. By declining to offer any rationale to explain this facially illogical result, the FCC utterly failed to live up to the requirements of reasoned decisionmaking. See, e.g., Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).[10]

Second, as explained more fully in the Supplemental Affidavit of Dennis B. Trimble ("Supp. Trimble Aff.") ¶¶ 8-11 (attached at Tab B), the FCC also acted arbitrarily by deriving its loop proxy prices from two cost models, the so-called "Benchmark Cost Model" and the "Hatfield 2.2" cost model, that the Commission itself expressly acknowledged "were submitted too late in this proceeding for the Commission and parties to evaluate them fully." First Report and Order ¶ 835. See id. ¶ 794 (relying on same cost models in fixing loop proxies). These models, moreover, systematically understated incumbent LECs' costs by excluding the costs of several essential components of the loop element. See Supp. Trimble Aff. ¶ 9.

C. In Any Event, the National Pricing Rules Imposed By the FCC Are Plainly Inconsistent With the Act and the Constitution.

Even if the Act could be construed to give the FCC authority over pricing, and even if the FCC had followed appropriate procedures under the Act, the specific rules set by the

[10] Similarly, for unbundled switching prices, the Commission failed to provide any explanation for the discrepancies between the evidence on which it was relying and its own definitions of the switching element and the proper measure of costs. As defined by the FCC, unbundled switching includes not only the basic function of connecting lines and trunks but also the full range of "features, functions, and capabilities of the switch," First Report and Order ¶ 412. The studies on which the FCC relied to set proxy prices, however, examined solely the costs associated with the basic function of trunk-to-line switching of additional minutes of traffic from an interconnecting carrier across the switch. See, e.g., Trimble Aff. ¶¶ 17, 18. The studies, thus, did not even purport to address the costs of other functions of the switch -- such as the special calling features the Commission purported to include. See Trimble Aff. ¶¶ 9, 15-20; Affidavit of Timothy J. Tardiff ("Tardiff Aff.") ¶¶ 2-14.

Commission are plainly unlawful. The FCC's rules not only prohibit States from even considering an incumbent LEC's actual historical costs, but also effectively deny LECs an opportunity to recover their full forward-looking costs. Neither result can be squared with the plain terms of the Act or with the Constitution.

1. The FCC's rules unlawfully prohibit States from even considering an incumbent LEC's historical costs in setting prices.

The Commission premised its pricing rule on the astonishing conclusion that States must be precluded from setting prices under § 252 that allow incumbent LECs to recover the historical costs of their networks -- i.e., to recover their actual investment in their existing infrastructure. See First Report and Order ¶¶ 704-707. Rather, the FCC concluded that States must "set [prices] at forward-looking long run economic cost." Id. ¶ 672. This conclusion runs afoul of the plain meaning of the Act and interprets the Act in a manner that would unnecessarily raise grave constitutional concerns.

The Act provides that in determining the prices for interconnection and network elements, state commissions should set a "just and reasonable rate" that is "based on cost" and may include a "reasonable profit." § 252(d)(1) (emphasis added). By its plain terms, § 252(d)(1) does not limit the kind of "cost[s]" a State may consider to forward-looking, or any other type, of cost. Rather, the Act directs States to set prices based on all costs of the incumbent LEC. The term "cost" in § 252(d)(1) thus no more excludes "historical costs" than the term "parents" would exclude mothers.[11] Astonishingly, the FCC concedes that the pricing standard specified by § 252(d)(1) "does not specify whether historical or embedded costs should be considered or

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[11] Moreover, by expressly providing that prices may include a "reasonable profit," the Act plainly contemplates that States may set prices to recover all of a LEC's costs, including the actual investments the LEC has already made in its network. After all, there could be no question of achieving profit if prices did not first fully recover all actual costs.

whether only forward-looking costs should be considered in setting arbitrated rates." First Report and Order ¶ 705. That concession should be the end of the line for the FCC's efforts to foist its pricing rules on the States. If the statutory standards governing pricing do not prohibit the States from considering historical costs, the FCC simply has no authority to eliminate such costs from the pricing calculus.

The FCC's categorical exclusion of historical costs not only conflicts with the plain terms of the Act but would also raise grave constitutional concerns. It is well settled that the Fifth Amendment "protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory." Duquesne Light Co. v. Barasch, 488 U.S. 299, 307 (1989). As the Supreme Court has explained, the Constitution thus requires that a utility be permitted to charge rates that will allow it to "maintain its financial integrity, to attract capital, and to compensate its investors for the risk [they have] assumed." Id. at 310 (quoting FPC v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944)). At a minimum, this standard requires that a regulated entity be allowed an opportunity to recover the actual costs it has prudently incurred in constructing the facilities it operates for public use. If a company could not even recover its actual capital outlays, it obviously could provide no return to investors, and thus could not possibly meet the constitutional standard. See Tenoco Oil Co. v. Department of Consumer Affs., 876 F.2d 1013, 1020 (1st Cir. 1989) (to meet constitutional standard "rates must provide not only for a company's costs, but also for a fair return on investment").

The Court's conclusion in Duquesne that constitutional analysis should focus only on the "total effect" of a rate order, rather than on the method of setting rates, in no way detracts from this principle. In concluding that the "subsidiary aspects of valuation" used in ratemakings are not of constitutional dimension, Duquesne, 488 U.S. at 310, the Court did not by any stretch suggest that a method for setting rates whose "total effect" was to deprive the regulated entity of any opportunity to recover its actual costs could pass constitutional muster. To the contrary, as Justice Scalia explained, since the constitutional standard requires that a utility be allowed a "fair return on investment," whatever method may be used in setting the rate, in judging the ultimate effect of the rates set by that method, there must be some minimum measure of the investment against which returns may be judged to be "fair." Duquesne, 488 U.S. at 317 (Scalia, J., concurring). And for that purpose, under the Constitution, "all prudently incurred investment may well have to be counted." Id. See also Duquesne, 488 U.S. at 310 (noting that the amount of capital upon which investors are entitled to earn a fair return has "constitutional overtones"). Indeed, as the Court's prior decisions holding that a company may not be forced to operate at a loss establish, a regulated entity must be allowed rates that will cover all of its actual costs. See, e.g., Brooks-Scanlon Co. v. Railroad Comm'n, 251 U.S. 396, 399 (1920) (Holmes, J.); cf. also Northern Pac. Ry. v. North Dakota, 236 U.S. 585, 596 (1915) (noting that a railroad cannot be forced to operate at less than cost and that "we entertain no doubt that, in determining the cost of the transportation of a particular commodity, all the outlays which pertain to it must be considered"); id. at 597 ("[W]hen conclusions are based on cost, the entire cost must be taken into account.").

Here, in contrast, the FCC's pricing method ensures that the prices imposed on incumbent LECs completely disregard the constitutional standard. By selecting a rate-setting mechanism that explicitly bars from consideration the basic criterion against which the validity of the rates must ultimately be judged -- historical costs -- the FCC's order raises grave constitutional concerns.